

Effective Pension Reform Process: The Importance of Clear Objectives

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Dr. Arun Muralidhar - Biography

❑ Pension Investments:

- Founder, M^{cube} and AEGIS – companies that help asset owners manage beta for alpha and risk management
- Graham-Dodd & Ed Baker (twice) awards; many clients won innovation awards for programs we designed
- Added significant value to client portfolios from beta management, especially in 2008
- Managed World Bank Pension Fund; Managing Director at JP Morgan Investments and FX Concepts
- Founding member of Univ of California DC Plan Advisory Board

❑ Author of Books on Effective Management of Portfolios:

- *Innovations in Pension Fund Management (Stanford University Press)*
- *SMART Approach to Portfolio Management (Royal Fern Publishing)*

❑ Social Security Reform:

- Co-author, with late Prof. Franco Modigliani, Nobel Prize Winner: *Rethinking Pension Reform (Cambridge University Press)*
 - ✓ *Offers a unique solution for the Social Security crisis – developed Guaranteed Return approach*
- Consultant to Govt. of Azerbaijan, proposed the Modigliani-Muralidhar reform model

❑ DC Plan Reforms (Uncovered Worker Plans):

- Manuscript Completed (2016): *50 States of Grey: An Innovative Solution to the DC Retirement Crisis*
- Advisor to Overture Financial (Consultant to CA Secure Choice Investment Board)
- Advisory Member, Council of Scholars - Georgetown Center for Retirement Initiatives
- Co-author with Prof. Robert Merton (Nobel Prize Winner) of the “*Flex MMM Model*” for uncovered workers
- Expert Advisor to World Economic Forum, Retirement Investment Systems project.

❑ Academic:

- Adjunct Prof. of Finance, George Washington University School of Business

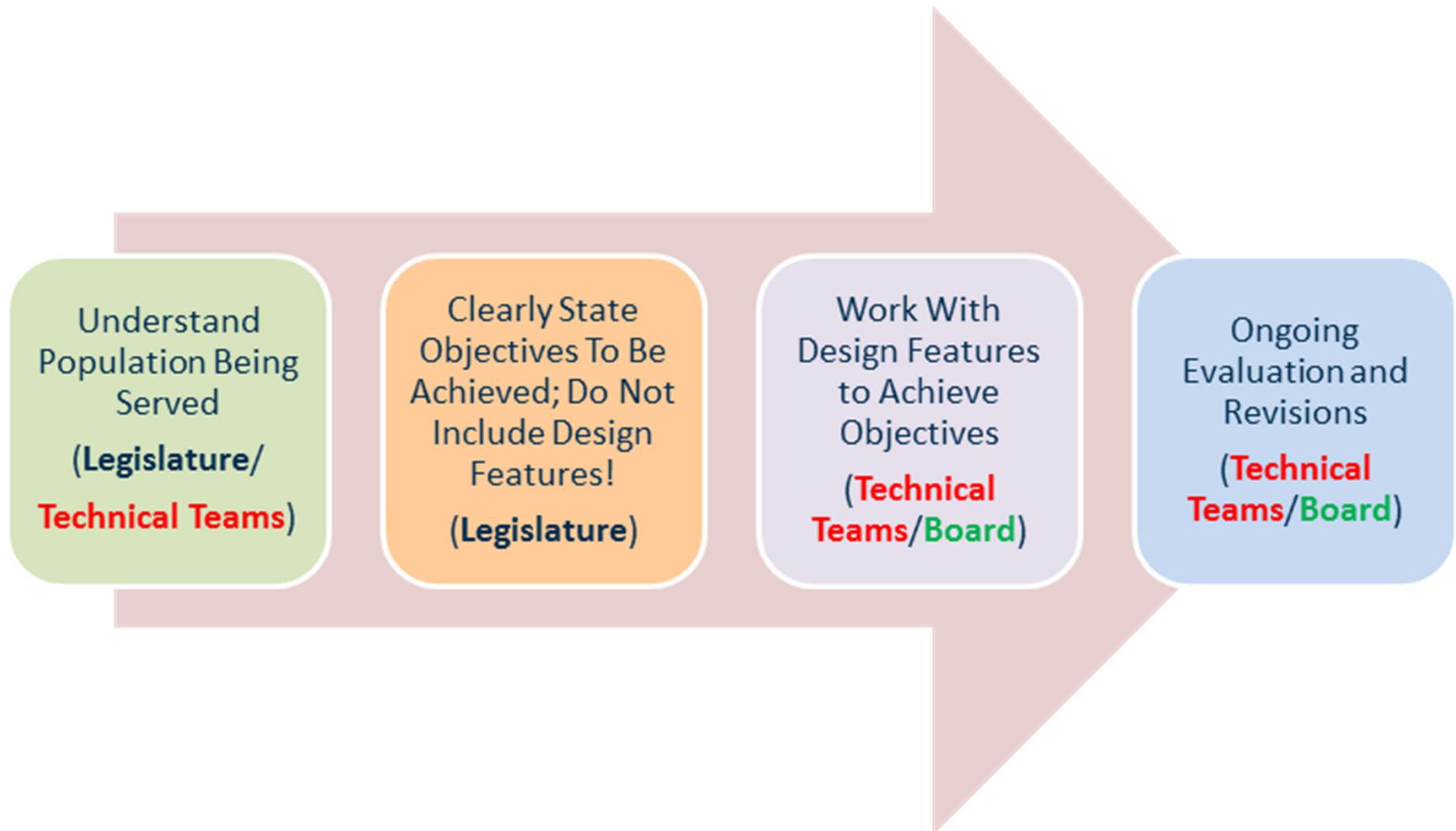
Disclaimer

- ❑ These are the personal views of the presenter and do not represent the views of any of the organizations he is affiliated with.
- ❑ Nothing contained in this presentation is meant to serve as investment advice and investors are urged to seek appropriate counsel prior to making any decisions.

Agenda –Process More Critical Than a Particular Model

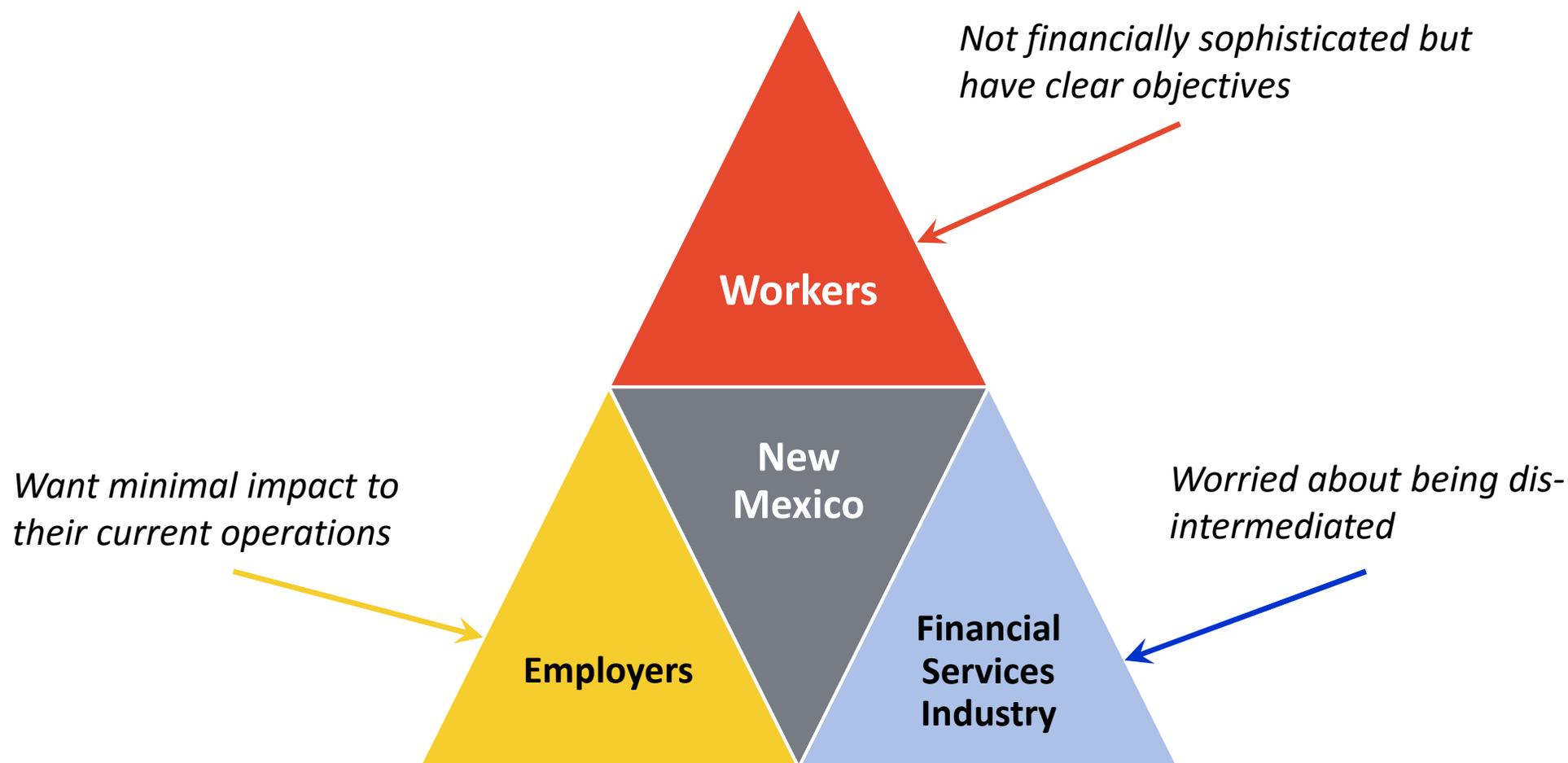
- ❑ **Good Reform Process** – How to Sequence Reforms
- ❑ **Stakeholders** – With Particular Focus on Participants (CA experience)
- ❑ **Example of Objectives** – Make it “SUPER ACCESSIBLE”
- ❑ **Design Features** – Keep Separate from Objectives in Legislation

Effective Process for Reform



Effective Process = Good and Timely Pension Design

Stakeholders: Four Main Groups



Need a Simple, Safe Investment Solution

Objectives: Participants (Using the CA Survey)

□ Core Objectives (80%):

- Clear ownership rights with account in their name
- Ability to bequeath balance to heirs
- Low cost investment options
- Access to information electronically
- Portability
- Ability to convert all or part of retirement savings into a monthly income stream

□ Secondary Objectives:

- Choice in decisions (74%)
- Access to funds pre-retirement (appx. 30% would opt-out without this feature)

Need a Simple, Low-Cost, Liquid and “Safe Choice”

Additional Feedback from Participants (Using the CA Survey)

□ Who Did They Trust the Most to Manage Their Money:

- Professional advisors (55 %)
- Financial companies (46 %)
- Employer (45 %)
- Insurance companies (40 %)
- Federal and state government (37 % each)

□ Ability to Save:

- 86% confident they could save for retirement. 4 % could not save anything
 - Appx. 30% not saving anything, + another 25 % saving 1 - 4 % of household income.
- The major issues that prevented them from saving included:
 - Insufficient income (81 %)/Pay-off debts (78 %)
 - Unexpected expenses (69 %)
 - Helping out family/unsure about how to invest/put it off (each about 65 %)
 - Unsure about how much to save (55 %)

Need a Simple, Low-Cost, Liquid and “Safe Choice”

Objectives: New Mexico, Employers and Financial Firms

□ States:

- Want to do something to help citizens for retirement
- No additional liability

□ Companies:

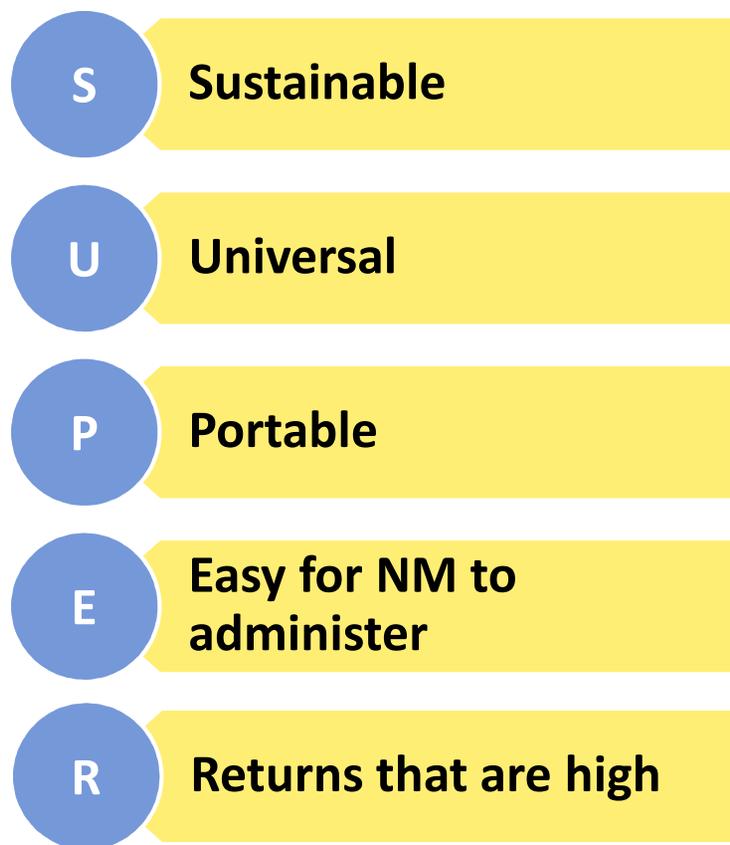
- Ease of implementation – typically small and may not even have a payroll provider
- Absolved of all legal liability

□ Financial Service Firms:

- Do not want government to dis-intermediate them from this business

Can States Articulate a Virtuous Blend of Competing Objectives?

Objectives Summarized: Make It “SUPER ACCESSIBLE”



Will Need to Ensure that Objectives Consistent with DoL Regulations

Objectives Summarized: Make It “SUPER ACCESSIBLE”

- A** Adequate pension
- C** Choice (of replacement rate)
- C** Certainty of outcome
- E** Easy for employers
- S** Smoothing of consumption
- S** Simple reporting

- I** Insulated from political risk
- B** Be inclusive of private sector
- L** Low costs
- E** Easy to regulate

Examples of Objectives Implied by Current Reforms in Just 2 States + the MMM Approach

Type of Plan	Sustainable	Insulated from Political Risk	Universal (If Yes, Mandatory or Voluntary)	Certainty of Outcome (If Yes, Real or Nominal)	Annuitization /Income Focused (Life or Term)	High Benefit to Contribution Ratio	Portable	Easy	Ease (and Level) of Regulation	Adequacy of Pension
CA	Yes	Yes	Mandatory with Opt-Out	No	No	Fees Capped	Yes (at least within CA)	Uncertain	TBD	Uncertain
CT	Not With Captive Insurance	Yes	Mandatory with Opt-Out	No	Life Desired	Fees Capped	Yes (at least within CT)	Uncertain	TBD	Uncertain
Merton-Modigliani-Muralidhar	Yes	Yes	Mandatory with Opt-Out	Real (High Degree of Certainty)	Term Easy; can hedge Life	Yes (but Depends on Vendor Fees)	Yes	Relatively	Will Be Needed	Likely

Start with Objectives First and Be Clear About What is Best for NM

Design Features (Not to be Confused with Objectives)

- **Design Features in Reform Legislation (Better Left to Technical Team)**
 - Investment Management: Who manages the portfolio
 - Asset Management: Single portfolio = “Pooled IRA”
 - Investment Outcome: Guaranteed returns on contributions
 - Terminal Outcome: Benefits must be in the form of an annuity

- **Effective Sequencing Requires Objectives and Design be Kept Separate**

- **Effective Design and Innovation Can Allow For Superior Outcomes**
 - ✓ Can have choice and manage as a single portfolio (as opposed to single return)
 - ✓ Possible to guarantee cash flows (as opposed to returns)
 - ✓ Choice could be of level of retirement cash flows (as opposed to portfolio)
 - ✓ In a well-designed system, can offer either retirement income or lump-sum

Have to Design a System Based on Objectives – Must be Simple

Summary – Feasible to Create “Individual DB”

- ❑ Important to have good reform process = ensures reform success
- ❑ Understand all stakeholder objectives
- ❑ Example of Objectives: SUPER ACCESSIBLE
- ❑ Understand participant and market limitations
- ❑ Can easily design an effective system that works best for New Mexico